No. 70-236

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

ESTATE OF LILLIE MACMUNN STEWART, Deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR *AMICI CURIAE*

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Statement

This Brief is submitted by the *Amici Curiae,* The New York State Bankers Association (Trust Division) and The Corporate Fiduciaries Association of New York City, in reply to the Brief for the Respondent in Opposition. Petitioner concurs fully in the views expressed herein.

Summary of Argument

All three of Respondent's legal arguments are destroyed by its own arguments in its Brief and in its Petition for Rehearing in the *Peoples Trust Co.* case (set forth in Pet. Supp. 13a-21a).

1. The government's Petition for Rehearing in *Peoples Trust Co.* destroys its Point 1, by conceding that state law differences are not legally significant to the proper application of section 2055, the laws of the various states being all based on the same equitable principles.

2. Respondent's citation of *State Street Trust Co.* v. *United States,* a case dealing with Massachusetts law and the inclusion of a trust corpus in a decedent's gross estate under sections 2036 and 2038, destroys its argument in Point 2, that *Old Colony Trust Co.* v. *United States* is not in conflict with the case at bar, because the case at bar "deals neither with Massachusetts law nor with inclusion of a trust corpus in a decedent's gross estate under Sections 2036 or 2038." [1]

3. Respondent's citation of *Colt* v. *Duggan* destroys its Point 3, that the issue herein "has been rendered moot for the future by amendments to Section 2055 of the Internal Revenue Code of 1954 enacted by the Tax Reform Act of 1969." Under *Colt* v. *Duggan* and the government's interpretation of the case at bar as revealed in its Petition for Rehearing in *Peoples Trust Co.*, no pre-Tax Reform Act charitable remainder trust would be entitled to an income tax charitable deduction in any future year for capital gains "permanently set aside for charity". Such trusts are numbered in the thousands.

4. The government's silences speak as eloquently as its admissions. It does not deny: (i) that the additional discretions given the trustee by Mrs. Stewart did not materially increase the trustee's power to shift economic inter-

[1] A second direct conflict with the decision in the case at bar has just been created by the Fourth Circuit's affirmance on September 1, 1971 of *Greer* v. *United States.* Petitioner will file a Second Supplemental Brief, appending the Fourth Circuit's opinion thereto.

ests between income beneficiary and remaindermen; (ii) that the valuation tables prescribed by the Commissioner are valid only on the assumption that all trustees' discretions will be impartially exercised; (iii) that there is no reason to believe that the discretions given the trustee in the case at bar will not be exercised impartially; (iv) that the chance that the charitable remaindermen will not receive the gift Mrs. Stewart intended is so remote as to be negligible; and (v) that the government's position, as set forth in its *Peoples Trust Co.* Petition for Rehearing, would result in the denial of income, gift and estate tax charitable deductions for all charitable remainders following income interests in trust, though settled law is to the contrary. In stating that there is "no conflict" and that the question presented is "moot", Respondent also conveniently omits reference to the more than 48 docketed cases involving this issue.

5. The question presented here has never been decided by this Court. In order to put an end to existing widespread controversy, and prevent extensive future burdensome litigation from clogging the federal courts, petitioner has shown overwhelmingly the need for this Court to grant the Petition for Certiorari and to correct the decision below.

Argument

1. Without being told, no one would believe that the government's Brief for the Respondent in Opposition and its Petition for Rehearing in the *Peoples Trust Co.* case (Pet. Supp. 13a-21a), were filed by the same party. Reasoning from the premise that the decision below is correct, Respondent in *Peoples Trust Co.* was all for "clarity and consistency in this area of the tax law" (Pet. Supp. 14a). Respondent submitted "that if New York's fiduciary law did not limit the *Stewart* trustee's

invasionary powers so as to satisfy the requirements of Section 2055, New Jersey law must equally be insufficient to satisfy the requirements of that section. The laws of these two states are based upon essentially the same equitable principles." (Pet. Supp. 19a-20a). And it concluded, "The mere fact that the two trustees may be held accountable to courts of different states, provides no adequate basis for the difference in outcome when these courts apply the same standards to review exercises of discretionary powers." (Pet. Supp. 21a).

In this Court, however, where the correctness of the decision below is hotly disputed, one hears nothing whatever from the government about the desirability of "clarity and consistency." Its efforts are directed to pointing out differences in the cases rather than discovering the underlying principles of law common to them. Not integration, but differentiation is the government's purpose here. So, writes Respondent, "the decision [below] turns largely upon a proper construction of state (here New York) law governing the administrative powers of a fiduciary." (Resp. 5). "That case [*Peoples Trust Co.*] involves New Jersey rather than New York law, and the opinion explains that it does not conflict with the opinion in the instant case." (Resp. 6-7, n. 1). So again, Respondent writes that Revenue Ruling 60-385 1960-2 Cum. Bull. 77 (and, of necessity, Revenue Ruling 55-620, 1955-2 Cum. Bull. 56, which was in force when Mrs. Stewart acted and which Revenue Ruling 60-385 overruled) "was concerned only with the effect of a power to allocate capital gains distributions of regulated investment companies to an income beneficiary—only one of the many possible administrative powers which may alter the dividing line between a charitable remainder interest and a noncharitable life estate." (Resp. 10, n. 3). And "of course," writes Respondent, the decision below does not conflict with *Old Colony Trust Co.*

v. *United States*, 423 F. 2d 601, 70-1, U. S. Tax Para. 12,667, 25 Am. Fed. Tax R. 2d 70-1549 (1st Cir. 1970) because the case at bar "deals neither with Massachusetts law nor with inclusion of a trust corpus in a decedent's gross estate under Sections 2036 or 2038." (Resp. 13).

The Petition for Rehearing in *Peoples Trust Co.* shows that the government has no difficulty whatever in perceiving and utilizing the common legal principles in these cases when it believes its purposes are served thereby. It exposes completely the pretense of the government's Point 1 (Resp. 5-12), that state law differences are material. The laws of the states are founded on the same equitable principles, and the fiduciary duties imposed on trustees are essentially the same everywhere.

2. Respondent's Brief in Opposition exposes the falsity of its Point 2 (Resp. 12-13), that the instant case and the *Old Colony Trust Co.* case are not in conflict.

Clearly stung deeply by our reproach that this case involves a retroactive application of a changed interpretation of the law by the Internal Revenue Service (*Am. Cur.* 5, n. 3) Respondent offers the following justification: "The decedent here had long been put on notice that the existence of broad administrative discretion in the trustee might render an otherwise deductible charitable interest unascertainable for federal tax purposes. See, *e.g., Colt* v. *Duggan*, 25 F. Supp. 268 (S.D.N.Y.); *State Street Trust Co.* v. *United States*, 263 F.2d 635 (C.A. 1.)" (Resp. 10, n. 3).

But *State Street Trust Co.* was not a charitable deduction case. It deals "with Massachusetts law" and "with inclusion of a trust corpus in a decedent's gross estate under Sections 2036 or 2038," [2] the very two circumstances

[2] Actually, sections 811(c) and 811(d) of the 1939 Code, which became sections 2036 and 2038 of the 1954 Code.

the government claims prevent *Old Colony* from conflicting with the case at bar (Resp. 13). If decisions under sections 2036 and 2038 involving Massachusetts law were relevant to the deductibility of Mrs. Stewart's gift in 1960, when she made it, they are relevant now.[3] The government's own words show its Point 2 is untenable. The conflict does exist, as the petition alleges (Pet. 19-24).

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[3] Respondent's statement (Resp. 12), that the Massachusetts court had "overruled prior law" between the times *State Street Trust Co.* and *Old Colony Trust Co.* which specifically overruled it, were decided, is incorrect. The First Circuit in *Old Colony* expressly stated that the Massachusetts court *"has twice criticized State Street for its seeming departure* [from Massachusetts law]" (423 F. 2d at 603) (emphasis supplied), and the Massachusetts court itself in *Worcester County National Bank* v. *King*, —— Mass. ——, 268 N.E. 2d 838 (1971) has made it crystal clear that Massachusets law on this point has been the same right along:

> "We trust that this opinion will serve to dissolve any remaining doubts concerning that supervision which Massachusetts courts sitting in equity will exercise over trusts containing broadly phrased clauses relative to trustees' administrative or management powers. Doubt in this area of the law was caused by the decision of the United States Court of Appeals, First Circuit, in *State Street Trust* v. *United States*, 263 F.2d 635, relying on broad language in *Dumaine* v. *Dumaine*, 301 Mass. 214, 16 N.E. 2d 625, a case which dealt with a fact situation far removed from this one. *In the intervening years we took occasion, most notably in the Silliman case, to dispel the misunderstanding engendered by the Dumaine case as interpreted by the State Street Trust Co. case.* [cites omitted] The First Circuit itself has recently reversed the view it took of Massachusetts law in *State Street Trust Co.* v. *United States, supra*, (*Old Colony Trust Co.* v. *United States*, 1 Cir., 423 F. 2d 601, 602-603)." (268 N.E. 2d at 841) (emphasis supplied).

State Street, like *Colt* v. *Duggan*, erroneously interpreted existing state law by failing to give full effect to the identical state law principle—the trustee's duty to exercise all his discretionary powers, both investment and administrative, impartially for the benefit of all beneficiaries—that is at the heart of this case. Respondent incorrectly suggests that *Old Colony* is not inconsistent with *State Street* (Resp. 12). *State Street* was "effectively overruled" by *Old Colony* (*Greer* v. *United States, supra*, n. 1).

3. By citing *Colt* v. *Dugan, supra,* the government refutes its own statement, elaborated on in its Point 3, that "the issue presented has been rendered moot for the future by amendments to Section 2055 of the Internal Revenue Code of 1954 enacted by the Tax Reform Act of 1969." (Resp. 5). Citation of this case shows that the government agrees with the statements in Petitioner's Supplemental Brief (at p. 8) and the Brief for *Amici Curiae* (at p. 13), that the issue herein affects the income tax liability of every charitable remainder income trust for all open and future years in which capital gains are realized. The specific question in *Colt* v. *Duggan* was whether capital gains realized by the trustee could be said to be "permanently set aside" for charitable purposes, and hence whether they were deductible under section 162 of the Revenue Act of 1932, the predecessor of present section 642(c)(2), in view of the trustee's broad administrative powers.[4] The issue herein is hardly "moot" and passage of the Tax Reform Act obviously did little to diminish the importance of the question in this case.

The government's tough position is ludicrous that Mrs. Stewart should have reasoned from a long discredited section 642(c)(2) case, and an always controversial and subsequently overruled section 2036 case, rather than from a 1955 Service ruling dealing directly with sections 170, 2055 and 2522, the income, estate and gift tax charitable deduction sections that Mrs. Stewart was trying to comply with. It simply emphasizes the injustice done Mrs. Stewart and other taxpayers similarly situated by the government's fail-

[4] In an exact foreshadowing of the downfall of *State Street Trust Co.* v. *United States* three decades later, *Colt* v. *Duggan,* which was decided on September 16, 1938, came to its end as a viable legal precedent on February 9, 1939, when the New York court construing the identical trust decided that the trustee had no right under New York law to do the things the federal district court had said he could. *Matter of Talbot,* 170 Misc. 138, 9 N.Y.S. 2d 806 (Sur. Ct. Orange Co. 1939).

ure to recognize that it had any obligation to guide taxpayers in this obviously difficult area of the tax law. Our statement bears repeating that "Many wills and trust agreements prepared in all good faith that became effective, or will become effective, between January 1, 1961 and October 9, 1972 and are now or will be in litigation would have been rewritten to conform to the changed rules if the draftsmen had only known new rules were in effect and what they were." (*Am. Cur.* 5, n. 3). Taxpayers like Mrs. Stewart are not tax dodgers to be dealt with so insensitively. All they wish to accomplish when making trusts of this kind is to discharge their primary obligations to themselves and their families and then give what is left to charity. They deserve better treatment at the hands of the government than this.

4. Respondent makes no effort to deny that the additional discretions given the trustee by Mrs. Stewart did not materially increase the trustee's power to shift economic interests between income beneficiary and remainderman (*Am. Cur.* 14-16); or that the valuation tables prescribed by the Commissioner are valid only on the assumption that all trustees' discretions will be impartially exercised (*Am. Cur.* 17-18); or that there is no reason to believe that the discretions given the trustee in the case at bar will not be exercised impartially (*Am. Cur.* 18-24); or that the chance that the charitable remaindermen will not receive the gift Mrs. Stewart intended is so remote as to be negligible (*Am. Cur.* 24-25); or that Respondent's position, set forth in its *Peoples Trust Co.* Petition for Rehearing, would result in the denial of income, gift and estate tax charitable deductions for all charitable remainders following income interests in trust, through settled law is to the contrary (Pet. Supp. 5-10). In stating that there is "no conflict" and that the question presented is "moot", Respondent also con-

veniently omits reference to the more than 48 docketed cases involving this issue listed in Respondent's Chief Counsel's Office (Pet. Supp. 10-11, 22a-23a.)

5. Respondent is less than candid in suggesting that prior decisions of the Supreme Court have settled the merits of the issue presented in this case (Resp. 5). While the merits are secondary to the primary issue presented by this Petition—the need to bring order out of the chaotic state of the law and to resolve the indefensible conflict among the circuits[5]—it is important not to be misled by Respondent's suggestion that the merits have already been decided by this Court. The prior decisions of this Court cited by Respondent (Resp. 5, 7-10) involved trust instruments which evidenced an affirmative intention on the part of the creator of the trust that principal should be invaded for the benefit of non-charitable beneficiaries, as expressed in the dispositive provisions of those instruments. What is new in this case is the government's fastening upon routine administrative provisions dealing with allocation of receipts and disbursements between principal and income which are invariably inserted in trust instruments by experienced draftsmen for the purpose of facilitating the orderly administration of the trust. This Court has not decided any case holding or implying that routine administrative provisions in trust instruments should determine their tax consequences.

By every standard—the significance of the legal issue, the confusion in the cases and conflict in the circuits, the number of taxpayers affected, the amount of revenue involved, the justice of taxpayer's case, and most important of all, the need to put an end to existing widespread con-

[5] The conflict continues to escalate. *Greer* v. *United States* (*Am. Cur.* 10) was affirmed by the Court of Appeals for the Fourth Circuit in favor of the taxpayer on September 1, 1971. (See n. 1).

troversy and stem the tide of litigation in the already heavily burdened federal courts[6]—Petitioner has shown overwhelmingly the need for this Court's granting the Petition for Certiorari and correcting the decision below.

CONCLUSION

Respondent has presented no convincing argument for denial of a Writ of Certiorari, and the Petition should be granted.

Respectfully submitted,

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[6] Already the tide of litigation is lapping at this Court's feet. Petitions for Certiorari to the Fifth Circuit were filed on July 7, 1971 in the *First National Bank in Palm Beach* case, and on September 3, 1971 in the *Miami Beach First National Bank* case (Pet. 10, Pet. Supp. 3).